

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF SOUTH KENTUCKY)	
RURAL ELECTRIC COOPERATIVE CORPORA-)	
TION OF SOMERSET, KENTUCKY, FOR AN)	CASE NO. 8268
ORDER AUTHORIZING AN INCREASE IN)	
ITS RETAIL RATES, APPLICABLE TO)	
ALL CONSUMERS)	

O R D E R

On June 29, 1981, South Kentucky Rural Electric Cooperative Corporation ("South Kentucky") filed with this Commission an application requesting authority to increase its revenues by approximately \$1,074,000 annually, an increase of 5.60 percent over normalized annual revenues. South Kentucky stated that the increase was necessary to maintain its financial position and to continue to operate on a sound financial basis.

On July 22, 1981, the Commission issued an Order scheduling a hearing for September 30, 1981, and directing South Kentucky to provide notice to its customers of the proposed increase and the scheduled hearing.

On July 7, 1981, the Consumer Protection Division of the Attorney General's Office filed a motion to intervene in this proceeding, which was sustained. No other parties of

interest formally intervened herein, although several letters and petitions were filed in opposition to the proposed increase. The hearing was conducted as scheduled at the Commission's offices in Frankfort, Kentucky, and the matter is now before the Commission for final determination.

COMMENTARY

South Kentucky is a consumer-owned rural electric cooperative engaged in the distribution and sale of electric energy to approximately 34,400 member-consumers in the Kentucky counties of Adair, Casey, Clinton, Cumberland, Laurel, Lincoln, McCreary, Pulaski, Rockcastle, Russell and Wayne. South Kentucky purchases all of its power from East Kentucky Power Cooperative, Inc.

TEST PERIOD

South Kentucky proposed and the Commission has accepted the 12-month period ending December 31, 1980, as the test period for determining the reasonableness of the proposed rates. In utilizing the historic test period, the Commission has given full consideration to known and measurable changes where appropriate.

VALUATION

South Kentucky proposed in its Exhibit H a net investment rate base of \$23,384,097. The Commission concurs with

this determination with the following exceptions: South Kentucky adjusted plant in service and construction work in progress to reflect changes subsequent to the test period. The Commission will allow only the test year-end levels for these components of the rate base. The Commission has adjusted materials and supplies, as well as prepayments, to reflect 13-month averages rather than the year-end levels presented by South Kentucky. The Commission has further adjusted the proposed rate base to reflect the pro forma adjustment to depreciation expense in the calculation of the accumulated provision for depreciation. South Kentucky proposed a level of working capital equal to one-eighth of pro forma operation and maintenance expenses including depreciation, taxes and other income deductions. The Commission will allow one-eighth of out-of-pocket pro forma operation and maintenance expenses, thereby excluding depreciation, taxes and other deductions, as the appropriate level of working capital for rate-making purposes.

The rate base has been reduced by \$188,677 to eliminate the balance in customer advances for construction at the end of the test period. The Commission is of the opinion that these advances are the equivalent of contributions of capital until their final disposition and should be treated as such for rate-making purposes.

Based on the Commission's adjustments, South Kentucky's net investment rate base for rate-making purposes is as follows:

Net Investment

Utility Plant in Service	\$ 29,975,300
Construction Work in Progress	231,107
Total Utility Plant	<u>\$ 30,206,407</u>
Add:	
Materials and Supplies	\$ 611,296
Prepayments	103,296
Working Capital	401,616
Subtotal	<u>\$ 1,116,208</u>
Deduct:	
Depreciation Reserve	\$ 8,051,639
Customer Advances for Construction	188,677
Subtotal	<u>\$ 8,240,316</u>
Net Investment	<u><u>\$ 23,082,299</u></u>

Capital Structure

The Commission finds from the evidence of record that South Kentucky's capital structure at the end of the test period was \$25,721,808 and consisted of \$9,410,565 in equity and \$16,311,243 in long-term debt. In the determination of this capital structure the Commission has excluded accumulated capital credit assignments from South Kentucky's wholesale power supplier in the amount of \$1,018,097.

The Commission has given due consideration to these and other elements of value in determining the reasonableness of the proposed rates.

REVENUES AND EXPENSES

In its Exhibit B South Kentucky proposed several adjustments to revenues and expenses to reflect more current

and anticipated operating conditions. The Commission finds the proposed adjustments are generally acceptable for rate-making purposes with the following modifications:

South Kentucky proposed an adjustment of \$2,978 to reduce operating revenue to reflect a discount of 10 percent on rental revenue from Duo County Telephone Cooperative. The record does not support the annual recurrence of this discount and the loss of this revenue during the test year cannot be reasonably expected to occur in the future. Therefore, the Commission will not accept South Kentucky's proposed adjustment to reduce revenue from pole rental.

South Kentucky proposed to adjust operating expenses by \$11,434 to reflect the increase in postal rates effective March 22, 1981. The Commission has increased this adjustment by \$6,995, to \$18,429, to reflect the additional postal rate increase that became effective November 1, 1981.

South Kentucky proposed an adjustment to increase administrative and general expenses by \$18,586 to reflect the increase in insurance rates effective January 1, 1981. At the hearing, South Kentucky filed a schedule of the increase in insurance rates effective November 15, 1981. The Commission therefore has increased the adjustment by \$45,083 to reflect the insurance cost currently experienced by South Kentucky.

South Kentucky proposed an adjustment of \$23,124 to reflect projected increases in the costs of employee pension

and savings programs. In supplemental information requested by the Commission, South Kentucky demonstrated that since the test year it had experienced increases in these costs in excess of what had been projected. Therefore, the Commission has increased the adjustment by \$11,725 to \$34,849 to reflect more current cost.

The Commission has reduced South Kentucky's operation and maintenance expense by \$16,561 to eliminate, for rate-making purposes, the cost incurred during the test year for a wage and salary survey. The Commission is of the opinion that this is an extraordinary, nonrecurring expense that should not be considered for rate-making purposes.

South Kentucky proposed an adjustment of \$10,843 to reflect anticipated increases in state and local property tax expense. Included in this adjustment was projected state tax of \$93,814. However, in the actual assessment notice received by South Kentucky for 1981, the state tax was only \$82,145. Therefore, the Commission will reduce the proposed adjustment by \$11,669 which results in a reduction of the actual test year expense for property tax of \$826.

South Kentucky proposed an adjustment to interest expense on long-term debt of \$47,160 to reflect normalized interest on all loans advanced through March 1981. Prior to the hearing on this matter South Kentucky drew down an additional \$1,152,000 in long-term debt from REA. The Commission, therefore, has increased the interest adjustment by \$57,600, to \$104,760, to reflect the expense on the additional debt.

The Commission has reduced South Kentucky's annual expenses by \$1,917 to exclude social and community contributions. The Commission is of the opinion that these expenses have little or no benefit to South Kentucky's consumers and should not be allowed for rate-making purposes.

South Kentucky proposed to adjust other income by \$22,749 to exclude capital credit assignments from associated organizations from income in the year in which they are assigned. South Kentucky contended that only capital credits paid during the test year of \$4,207, which were assigned during 1973, should be recognized as income for rate-making purposes. However, no evidence was offered that the level of credits realized during the test year would not be realized prospectively. Therefore, the Commission is of the opinion that these credits should be recognized as income in the year they are assigned and the proposed adjustment should not be accepted for rate-making purposes.

The Commission adjusted South Kentucky's base rates in Case No. 8081 to roll-in to the base rates the fuel cost of its wholesale power supplier. In addition to the roll-in of current fuel costs, the Commission revised the method of calculating the monthly fuel adjustment charge to allow for over- and under- recoveries of the preceding month's fuel charge or credit. This revision will allow total recovery of fuel adjustment charges through the fuel adjustment clause. Therefore, the Commission has increased revenue by \$71,893 and

decreased purchased power expense by \$24,494 to exclude the fuel revenue and cost incurred during the test year. Likewise, in determining the normalized revenue and power cost the Commission has excluded the normalized fuel revenue and expense proposed by South Kentucky.

The effect on net income of the revised pro forma adjustments is as follows:

	<u>Actual Test Period</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$15,741,723	\$3,924,495	\$19,666,218
Operating Expenses	14,668,358	4,078,431	18,746,789
Operating Income	\$ 1,073,365	\$ (153,936)	\$ 919,429
Interest on Long-Term Debt	828,812	104,760	933,572
Other Income and (Deductions) - Net	276,053	(3,218)	\$ 272,835
Net Income	<u>\$ 520,606</u>	<u>\$ (261,914)</u>	<u>\$ 258,692</u>

RATE OF RETURN

South Kentucky was granted its last rate increase in October 1978. In that case the Commission allowed additional revenue sufficient to produce a 2.0 TIER. Since that time South Kentucky has achieved a TIER of 2.31 for calendar year 1979 and 1.63 for 1980. These earnings result in an average TIER of 1.97 for the most recent calendar years. The calendar year 1981 financial statements have not been filed with the Commission at this time, however, the most recent monthly reports reflect a TIER of 1.99 through October 1981 and 1.65 through November. The Rural Electrification Administration, South Kentucky's principal lender, requires its borrowers to

maintain an average TIER of at least 1.5 for 2 out of the most recent 3 calendar years.

In this matter South Kentucky has requested additional revenue sufficient to produce a TIER of 2.49. The witness for South Kentucky, Mr. Bradley, testified that this TIER was required to allow South Kentucky to maintain its current equity position. South Kentucky did not testify as to the need to maintain its current equity level or to its desired equity level. South Kentucky has maintained an equity to total asset ratio of above 35 percent for the past 10 years. At the end of the test year this ratio was 36 percent.

South Kentucky achieved a rate of return on the net investment rate base established herein for the test year of 4.65 percent. After taking into consideration the pro forma adjustments South Kentucky would realize a rate of return of 3.98 percent. The Commission is of the opinion that the adjusted rate of return is inadequate and that a more reasonable rate of return is 7.51 percent. In order to achieve this rate of return, South Kentucky should be allowed to increase its annual revenue by \$814,916, which will result in a TIER of 2.15. This additional revenue will provide income of \$1,073,608 which should be sufficient to meet the requirements in South Kentucky's mortgages securing its long-term debt.

Revenue Allocation and Rate Design

South Kentucky requested several changes in rate design. A new rate schedule was proposed for television boosters,

which have been served under schedule B. South Kentucky determined that the rates under schedule B were excessive for this service.^{1/} South Kentucky proposed to change the rate structure for schedules A and B from a four-step declining block to a two-step rate plus a customer charge to bring its rate-making theory into closer alignment with PURPA.^{2/} South Kentucky requested limiting the OPS schedule to customers with no more than 300 KVA transformer capacity. Larger customers would be transferred to schedule LP where their demand usage could be metered and billed. Customer charges were requested for schedules OPS and LP. South Kentucky proposed making the energy charges for schedule OPS more similar to the LP rate design. OPS customers may elect to be served under schedule LP. The proposed rate structure change should allow customers to more easily compare the two schedules. South Kentucky proposed to eliminate two rates which had no billings during the test year, the demand charge for over 10 kilowatt use in schedule B and the end block energy charge in schedule LP. The Commission is of the opinion that the requested changes are reasonable and should be allowed.

South Kentucky proposed to allocate the requested revenue increase to rate classes in approximately the same proportions as the classes are currently contributing to gross revenues. Two exceptions are that charges for television

^{1/} Response to Staff Request No. 2, page 4.

^{2/} Ibid.

boosters are reduced and that a larger increase is allocated to schedule OPS. South Kentucky determined that the demand load of the OPS customers warranted a larger increase.^{3/} The Commission is of the opinion that the proposed allocation is reasonable. The rates in Appendix A reflect a similar method of allocating the approved revenue increase.

SUMMARY

The Commission having considered the evidence of record and being advised, is of the opinion and finds that:

1. The rates in Appendix A are the fair, just and reasonable rates for South Kentucky and will produce gross annual revenue sufficient to pay its operating expenses, service its debt, and provide a reasonable surplus for equity growth.

2. The rates proposed by South Kentucky would produce revenue in excess of that found to be reasonable herein and therefore should be denied upon application of KRS 278.030.

IT IS THEREFORE ORDERED that the rates in Appendix A, attached hereto and made a part hereof, are approved for service rendered by South Kentucky Rural Electric Cooperative Corporation on and after February 1, 1982.

IT IS FURTHER ORDERED that the rates proposed by South Kentucky are hereby denied.

^{3/}

Ibid.

IT IS FURTHER ORDERED that within 30 days from the date of this Order South Kentucky shall file with the Commission its revised tariff sheets setting out the rates approved herein.

. Done at Frankfort, Kentucky, this 2nd day of February, 1982.

PUBLIC SERVICE COMMISSION

Martin W. Woff
Chairman

Katherine Randall
Vice Chairman

Jim Carver
Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 8268 DATED FEBRUARY 2, 1982

The following rates and charges are prescribed for the customers in the area served by South Kentucky Rural Electric Cooperative Corporation. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the date of this Order.

CLASSES OF SERVICE

Members of the Cooperative are served under the following classification and applicable Rate Schedules:

Schedule A - Residential, Farm and Non-Farm
Schedule A - Public Buildings
Schedule B - Small Commercial
Schedule LP - Large Power
Schedule OPS - Optional Power Service (Limited to 300 KVA)
Schedule OL - Outdoor Lighting (Security Lights)
Schedule STL - Street Lighting
Schedule TVB - Unmetered Commercial Service

For information as to the availability, rates, charges, type of service terms, etc., of the above mentioned services, see applicable rate schedule, a copy of which is attached hereto and made a part thereof.

SCHEDULE A RESIDENTIAL, FARM AND NON-FARM SERVICE*

RATES PER MONTH:

Consumer Charge - No KWH Usage \$5.00

Energy Charge:

First 700 KWH per Month @ \$.04982
All over 700 KWH per Month04355

MINIMUM CHARGE: The minimum monthly charge shall be the "Consumer Charge - No KWH Usage" as stated in Rates per Month above.

SCHEDULE B
SMALL COMMERCIAL RATE*

RATES PER MONTH:

Consumer Charge - No KWH Usage \$6.00

Energy Charge:

First 1,000 KWH per Month @ \$.05445
All Over 1,000 KWH per Month @04938

MINIMUM CHARGE:

- (a) Single Phase Service shall be the Consumer Charge - No KWH Usage as stated in the Rates per Month.
- (b) Three Phase Service shall be determined by applying \$.80 per KVA of transformer capacity installed. The Seller may, if it so desires, install transformer (s) of capacity larger than required but in such case the consumers minimum bill shall be based on the standard transformer size which would have been adequate for consumers load.

SCHEDULE LP
LARGE POWER RATE*

AVAILABILITY: Available to all commercial and industrial consumers who require excess of 50 KVA transformer capacity for lighting and/or heating, and/or power. Consumers served under this schedule may request service under the OPS Schedule if they so desire provided the request is made in advance and not more than once every 12 months and provided KVA requirement is not in excess of 300 KVA.

RATES PER MONTH:

Consumer Charge - No KWH Usage \$10.00

Demand Charge:

Billing Demand per KW per Month 4.25

Plus Energy Charge:

First 3,500 KWH per Month @ \$.03759
Next 6,500 KWH per Month @03604
Next 140,000 KWH per Month @03305
Next 150,000 KWH per Month @03293
Over 300,000 KWH per Month @03284

MINIMUM CHARGE: The minimum monthly charge shall be the highest one of the following charges:

- (a) The Consumer Charge-No KWH Usage as stated in Rates Per Month, or
- (b) The minimum monthly charge as specified in the contract for service, or
- (c) A charge of \$.80 per KVA of required transformer capacity. The Seller may, if it so desires, install transformers of capacity larger than required, but in such case, the Consumer's minimum bill shall be based on the standard transformer size which would have been adequate for consumer's load.

SCHEDULE OPS
OPTIONAL POWER SERVICE*

AVAILABILITY: Available to all commercial and industrial consumers who require excess of 50 KVA but limited to no more than 300 KVA transformer capacity for lighting, and/or heating and/or power. Consumers served under this schedule may request service under the LP Schedule if they so desire provided the request is made in advance and not more often than once every 12 months.

RATES PER MONTH:

Consumer Charge - No KWH Usage \$10.00

Energy Charge

First	3,500 KWH per Month @	\$.05987
Next	6,500 KWH per Month @	.05740
Next	140,000 KWH per Month @	.05264
Next	150,000 KWH per Month @	.05245
Over	300,000 KWH per Month @	.05231

MINIMUM CHARGE: The minimum monthly charge shall be the highest one of the following charges:

- (a) The Consumer Charge - No KWH Usage as stated in Rates Per Month, or
- (b) The minimum monthly charge as specified in the contract for service, or
- (c) A charge of \$.80 per KVA of required transformer capacity. The Seller may, if it so desires, install transformers of capacity larger than required, but in such case, the Consumer's minimum bill shall be based on the standard transformer size which would have been adequate for consumer's load.

SCHEDULE STL
STREET LIGHTING SERVICE*

Rate:

Mercury Vapor Bulbs

Up to and including 175 watts (74 KWH/Light) \$3.43

Excess of 175 Watts up to and including \$5.79
400 Watts (162 KWH/Light)

Sodium Bulbs

Up to and including 150 Watts (63 KWH/Light) \$4.58

Excess of 150 Watts up to and including \$6.67
360 Watts (135 KWH/Light)

CONDITIONS OF SERVICE

3. All lamp replacements shall be made by the Cooperative. Lamp replacements may be charged to the applicant at cost as a separate item on the monthly bill for service.

SCHEDULE OL
OUTDOOR LIGHTING SERVICE - SECURITY LIGHTS*

Rates:

175 Watt Mercury Vapor - Metered \$3.55

175 Watt Mercury Vapor - Unmetered \$5.02
(74 KWH/Light)

SCHEDULE TVB
UNMETERED COMMERCIAL SERVICE

APPLICABLE: In all territory served by the Seller

AVAILABILITY: To all commercial services for which the monthly KWH and KW demand is reasonable constant and which is not practical to install and maintain proper metering equipment as determined by the Seller.

TYPE OF SERVICE: Single-phase or three-phase as available, 60 cycle at available secondary voltage.

CLASS AND RATES PER MONTH:

Cable TV Amplifiers - (75 KWH per Month) \$6.40

FUEL ADJUSTMENT CLAUSE: As shown in Appendix B following these tariffs.

TERMS OF PAYMENT: The above rate is net.

*Fuel Adjustment

All rates are applicable to the Fuel Adjustment Clause and may be increased or decreased by an amount per KWH equal to the fuel adjustment amount per KWH as billed by the Wholesale Power Supplier plus an allowance for line losses. The allowance for line losses will not exceed 10% and is based on a 12-month moving average of such losses. This Fuel Clause is subject to all other applicable provisions as set out in 807 KAR 50:075.